BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
SECURITY FIRST NATIONAL BANK)

Appearances:

For Appellant: Charles H. Chase, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Security-First National Bank for refund of franchise tax and interest in the amount of $24,061.85 for the income year 1950.

In 1949 Assets Corporation (hereinafter referred to as Assets) was heavily indebted to the Appellant, a national bank located in California. Pursuant to an agreement with the stockholders of Assets, Appellant canceled a portion of the debt owed to it by Assets in exchange for all of the latter's properties. Among the assets transferred to the Appellant on November 10, 1949, were 12,600 shares in the Flintridge Realty Company (hereinafter referred to as Flintridge) which constituted 89% of that firm's outstanding stock. By December 30, Appellant had acquired the remaining Flintridge shares. In February, 1950, Flintridge was liquidated and all of its assets were distributed to the Appellant. During 1950 a large part of the assets so distributed, including realty and some Valley Water Company stock were sold.

In its franchise tax return for the income year 1950, the Appellant claimed a loss of $256,719.32 from the sale of the assets, using Flintridge's basis in computing the loss. The Franchise Tax Board disallowed this deduction and made an assessment which Appellant has paid. Appellant now seeks a refund.

The Franchise Tax Board concedes that Appellant's claim would be correct were it not for the fact that the liquidation of Flintridge was merely a step in an integrated plan to acquire its underlying assets. It concludes that the Appellant's basis for the property in question should be the cost to Appellant of the Flintridge stock. There is no dispute over the fact that such an adjustment would require denial of the refund here in question.

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During the year involved, Sections 20(b)(6) and 21(a)(12) of the Bank and Corporation Franchise Tax Act provided in essence that the basis of property shall be its cost except that the basis of property acquired in complete liquidation of a subsidiary shall be the same as it would be in the hands of the transferor. These sections have their counterparts in the United States Internal Revenue Code. Based upon the concept that the incidence of taxation depends upon substance rather than form, the Federal courts have established the rule that where a corporation seeks to acquire the assets of another corporation, intermediate steps of stock purchase and liquidation will be ignored and the transaction will be treated as the direct acquisition of assets rather than as the liquidation of a subsidiary. (Commissioner v. Ashland Oil & Refining Co., 99 F. 2d 588, cert. den. 306 U. S. 661; Kimbell-Diamond Milling Co., 14 T. C. 74 aff'd 187 F. 2d, 718, cert den. 342 U. S. 827.) This principle is referred to as the Kimbell-Diamond rule.

The Appellant states that it acquired the stock only in order to salvage as much as possible from the debt owed it. Accepting this statement, it is nevertheless incomplete in that it merely states the goal, but not the means intended to accomplish such an end. Appellant itself states that the most feasible method for accomplishing this result was liquidation of Flintridge and sale of its assets. Since this method was used, it seems clear that Appellant did intend to strip away the corporate super structure of Flintridge in order to acquire and sell the underlying properties. If Appellant entertained this purpose at the time it acquired the Flintridge stock, the Kimbell-Diamond principle was properly applied. (United States v. Mattison, 273 F. 2d 13; United States v. M. O. J. Corp., 274 F. 2d 713.)

Appellant makes the unsupported assertion that the decision to liquidate Flintridge and sell its properties was not made until after receipt of the Flintridge stock from Assets Corporation. This assertion is contradicted by the Franchise Tax Board and is not borne out by the uncontroverted facts surrounding the transaction.

It may be that when Appellant speaks of a "decision" it means the formal adoption of a detailed plan of liquidation and sale. The requisite purpose may exist in the absence of such formality. (See Commissioner v. Ashland Oil & Refining Co., supra.) It appears unlikely that Appellant would have entered into the transaction with Assets Corporation in order to salvage as much as possible of the debt involved without any consideration of how to dispose of the properties it was to receive. Appellant admits that it acquired the 11% minority interest in Flintridge with a view toward liquidation. The fact that Appellant set about acquiring the minority interest immediately after the transfer by

Assets strongly suggests that liquidation was contemplated before the transfer. (See Koppers Coal Co., 6 T.C. 1209.) Considering all the circumstances, we conclude that the rule established by Kimbell-Diamond Milling Co., supra, is applicable and that the basis for computing gain or loss on the sale of the assets of Flintridge is the cost to Appellant of the Flintridge stock.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 26077 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claim of the Security First National Bank for refund of franchise tax and interest in the amount of $24,061.85 for the income year 1950, be and the same is hereby sustained.

Done at Secramento, California, this 7th day of March, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary